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TAGS: ECON EFIN ETRD EINV SN

SUBJECT: ECONOMISTS QUESTION FUTURE OF SINGAPORE'S GROWTH MODEL

¶1. (SBU) Summary: As Singapore recovers from another recession brought on by events outside its borders, local economists have begun to question Singapore's economic growth model. In past decades Singapore utilized an extraordinary openness to foreign investment and labor to quickly grow its economy to developed status, but this same openness has exposed the small city-state to volatile economic swings outside its borders, as well as unforeseen domestic impacts from a steady stream of foreign workers. In May 2009 the government established an Economic Strategies Committee that will put forth preliminary recommendations next week to prepare the country for sustained and inclusive economic growth by looking for new growth opportunities. Several noted local economists believe the committee's recommendations must address structural problems inherent in Singapore's growth model, including declining productivity growth, an overdependence on external markets and foreign enterprises and workers, and a widening income gap among Singaporeans. End Summary.

Is The Singapore Model Still Valid?

¶2. (SBU) In the wake of Singapore's worst recession since independence in 1965, local economists are questioning whether the economic growth model that lifted Singapore into the developed world is still valid, or whether significant changes must be made to guide the economy forward. The financial crisis that rocked the global economy in late 2008 impacted Singapore particularly hard, exposing its vulnerability to the economic ebbs and flows outside its borders. As a small, open economy heavily dependent on trade, Singapore has ridden the wave of globalization to new heights of wealth, but economic crises over the years in the region and in its major markets have inordinately buffeted the tiny city-state. Its openness to foreign workers and businesses brought new investment and talent, but also concerns of a widening disparity of incomes and declining productivity.

¶3. (SBU) Few would argue that Singapore could ever turn inwards and relinquish its long-standing role as a gateway in the region for trade and investment. However, local economists have been considering how Singapore's economy could be restructured to fuel future growth, and for whom the economic growth should benefit. As the country begins to retune the economy, economists believe that economic policymakers must take into consideration structural issues that may slow Singapore's path ahead, including lagging productivity growth, its dependence on external markets, low domestic demand, and growing income inequality.

¶4. (SBU) The Singapore government has joined the debate, announcing in May 2009 the establishment of an Economic Strategies Committee (ESC) composed of members from the government, labor and the private sector to develop economic strategies and examine new opportunities in the changed global environment. The 25-member Committee has been studying how to seize new growth opportunities, deepening Singapore's corporate capabilities, growing human capital, creating

good jobs, and optimizing use of scarce energy and land resources. The ESC will present its initial recommendations February 1 just ahead of this year's budget release later that month. The committee's recommendations are intended to guide Singapore's economic strategy in the medium term. A full report is due in mid-2010.

Productivity on the Downtrend

¶5. (SBU) Singapore's productivity growth has been languishing since 2004, and in recent years productivity has dropped into an outright decline. Although Singapore has continually posted exceptional GDP growth rates rarely seen in the developed world, in recent years it has been growth in the labor force rather than productivity improvements that have driven GDP growth. In a recent report, Citigroup calculated that of the 8.2% average growth from 2004-7, only one-fifth was driven by productivity growth. Singapore's non-resident labor force grew almost 20% between 2006 and 2008, and foreigners now account for approximately 34% of the labor force. The influx of labor has meant that strong GDP growth has not translated into a similar growth in wages. In the last five years overall nominal GDP growth has outstripped per capita GDP growth. The recent recession sent productivity into a further tailspin as companies used government incentives to keep workers on the payroll even as industrial production nosedived.

¶6. (SBU) Economists put much of the blame for the lack of improvements in productivity on the easy availability of imported low-cost unskilled labor. Of the approximately one million foreign workers in Singapore, 80% are unskilled or semi-skilled workers, many of whom brought in on short-term contracts to work in

construction and light manufacturing. Dr. CHOY Keen Meng, professor of economics at Nanyang Technological University, told Econoff that the cheap imported labor had contributed to stagnant wages at lower income levels, helping to widen the income divide in Singapore. Choy said tightening the taps on immigration and foreign labor would push up wages and incentivize companies to substitute capital for labor and become more productive. He conceded that Singapore would continue to need foreign labor as the country's fertility rate is below replacement level, but advocated being more selective by recruiting higher skilled laborers, which would also help improve productivity. Although a more restrictive policy on foreign labor would inevitably reduce GDP growth rates, Dr. Choy said a slower pace of growth would in the end be more sustainable given Singapore's limited land and resources.

¶7. (SBU) More restrictive policies on foreign labor could have negative impacts that the GOS will need to consider. Dr. Choy warned that the GOS had attempted to improve productivity through encouraging wage increases in the 1980s which contributed to Singapore falling into recession in 1985. Higher wages could also spark inflation as Singaporeans would require higher wages to be enticed to take jobs currently held by foreigners. Other jobs would likely disappear for good as low-wage industries move offshore as labor costs become uncompetitive.

Offshore Waves Rock Singapore's Boat

¶8. (SBU) The recent economic crisis reminded Singaporeans that their economic growth is highly dependent on overseas markets. Economists are concerned that Singapore's export industries have become dangerously dependent on their primary "G3" markets in Europe, Japan and the United States that have recently become volatile. At its height the crisis cut Singapore's non-oil exports by over a third, and also crippled the country's extensive shipping, logistics and other service industries that support international trade. International trade has long been the lifeblood of Singapore's economy, with its imports and exports totaling 350% of its GDP, one of the highest levels in the world.

¶9. (SBU) To offset its traditional export destinations, Singapore has been searching out new markets in Latin America, India and

China. Although trade with China has been growing rapidly, much of the trade is in intermediate products whose final markets tend to be the same G3 countries to which Singapore already exports heavily. NTU's Dr. Choy said that demand from China is beginning to contribute to regional growth, and said the government had made big efforts to expand markets in other regions like Russia and the Middle East, but that in the medium term they would not be able to replace traditional markets.

Building Domestic Demand

¶10. (SBU) As a small city-state Singapore has little option than to continue with international trade and foreign investment as major parts of its economy. However, as Singapore's population crosses the five million mark, domestic demand is becoming a force to be reckoned with, and economists are considering ways to boost lagging domestic demand and reduce the economy's dependence on foreign consumption. Domestic consumption is currently 40% of GDP, down from over 60% in the 1970s.

¶11. (SBU) Domestic consumption has been low in part to an unusually high savings rate. Dr. Choy told Econoff that a regression analysis found that high property prices were one of the most significant depressors of consumption. In a country where most residents own their own home, Singaporeans have become accustomed to saving large amounts in order to afford expensive housing purchases, leaving relatively little for other purchases. The government also contributes to high savings rates through a compulsory nationwide saving plan, and by squirreling away budget surpluses into reserves and its sovereign wealth funds which hold hundreds of billions in dollars worth of assets. The government insists high levels of reserves are necessary for emergencies, but Dr. Choy recommends transferring surpluses back to the population and selling off shares in government-linked companies to allow Singaporeans to hold a greater share of the nation's wealth.

¶12. (SBU) Economists also advocate policies to support local small and medium-sized enterprises (SME) which have often been ignored in the drive to attract investments from large multi-national corporations (MNC). Manu Bhaskaran, head of economic research at Centennial Group, told a recent economic forum that Singapore had relied on MNCs early in its development to attract capital, management and technology. However, recent data show that

foreign-owned companies receive almost half of business profits. Bhaskaran said the time had come to develop the "inherent capacity" of the country, advocating development of worker skills and local intellectual property. A recent Citigroup study also advocated encouraging SMEs by facilitating technology transfer, penetrating foreign markets for locally produced goods and services, and promoting domestic brands. Bhaskaran said stronger local businesses would also stabilize and smooth business cycles.

¶13. (SBU) Economists also see a gradual shift from manufacturing to a services-based economy as a means to boosting domestic demand and smoothing the volatility in the business cycle. As a small open economy like Singapore, an increase in domestic demand has typically been expected to bring a rise in imports rather than a commensurate boost to domestic production. However, domestic demand in Singapore leans more to consumption of services, relatively little of which are imported. Domestic service industries are also ripe for new export opportunities as markets in the region, particularly China, shift rising consumption from basic food and clothing into services. Service industries expected to prosper in coming years include medical services, financial services, education, transportation, and other specialized services in which Singapore is a clear leader. Dr. Choy pointed out that service industries have also become more labor-intensive and are better sources of employment than manufacturing, particularly the high-end capital-intensive manufacturing that has found a niche in Singapore.

Growing Income Inequality

¶14. (SBU) Economists view Singapore's focus on rapid GDP growth as masking slower growth in overall welfare, and a growing income divide. Singapore has one of the highest per capita incomes in the world; the IMF listed Singapore as 22nd highest in 2008 with a per capita income of US$38,972. However, Centennial Group's Manu Bhaskaran estimates profits take about 46% of that GDP pie, almost half of which go to foreign companies. Much of the economy's recent high growth was concentrated in high-end manufacturing and finance, dominated by foreign companies. Bhaskaran notes that although Singapore's GDP per capita is roughly 11% higher than Hong Kong's, per capita consumption is 21% lower.

¶15. (SBU) Singapore's income divide as measured by the Gini coefficient has been rising steadily in recent years from .42 in 1998 to .48 in 2008, one of the highest rates in the developed world. The stream of unskilled foreign labor has depressed wages at the lower end and contributed to a widening income gap. At the same time, cuts in corporate and personal income tax rates to encourage business have disproportionately benefited higher income groups. According to a recent Citigroup report, real household incomes for the bottom quintile of households actually fell in the years after the 1997 financial crisis and 2001 recession and have only recently begun to creep upwards again.

¶16. (SBU) The Singapore government has begun to recognize the growing income inequality and is changing policies to address it. In previous economic downturns the government focused its efforts on restraining wages and reducing costs for business, but last year's stimulus budget in reaction to the economic crisis used state funds to preserve jobs by extending worker retraining programs and subsidizing salaries. The government has been reticent in the past about building a social safety net, fearing it would reduce incentives to work and damage Singapore's competitiveness. However, economists expect the government to go beyond current health, housing and retirement programs and put in place programs to provide a cushion against economic downturns. A more solid net would not only serve as an automatic fiscal stabilizer during difficult economic times, but would also improve social cohesion and guard against a potential reaction to globalization.

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